

# **CAPITAL PROJECTS AND BOND OVERSIGHT COMMITTEE**

## **Minutes**

**November 16, 2004**

The Capital Projects and Bond Oversight Committee met on Tuesday, November 16, 2004, at 1:00 PM, in Room 129 of the Capitol Annex. Senator Robert Leeper, Chair, called the meeting to order, and the secretary called the roll.

Present were:

Members: Senator Robert Leeper, Co-Chair; Senators Tom Buford, Virgil Moore, and Jerry Rhoads; and Representatives Robert Damron, and Paul Marcotte.

Guests testifying before the Committee: Robert Wiseman and Rob Mullins, University of Kentucky; John Osborne and Dr. Jennifer Tougas, Western Kentucky University; Bill Hintze, Governor's Office for Policy and Management; Jim Abbott and Steve Biven, Finance and Administration Cabinet; Warren Nash, Economic Development Cabinet; Sandy Williams, Kentucky Infrastructure Authority; Tom Howard, Office of Financial Management; and Lori Flanery, Kentucky Housing Corporation.

LRC Staff: Mary Lynn Collins, Pat Ingram, Nancy Osborne, Kevin Mason, Bart Hardin, and Shawn Bowen.

Representative Marcotte made a motion to approve the minutes of the October 19, 2004 meeting as submitted. The motion was seconded by Senator Buford and passed by voice vote.

Senator Leeper called on Ms. Collins to review correspondence and information items. Ms. Collins said members' folders contained one item of correspondence from the Council on Postsecondary Education relating to unbudgeted projects that are on today's agenda.

Ms. Collins said Committee member folders also included the Kentucky Lottery Corporation's (KLC) monthly financial report for September 2004 and a staff update on various capital projects. She noted the staff update included an article stating Moody's Investor's Service recently removed the Commonwealth from its watchlist for a possible downgrade in the state's bond rating.

Representative Damron made a motion to approve the minutes of the October 19, 2004 meeting as submitted. The motion was seconded by Senator Moore and passed by voice vote.

Senator Leeper asked Mr. Bob Wiseman, Associate Vice President for Facilities, University of Kentucky (UK), to present a project report for the University. Mr. Wiseman introduced Mr. Rob Mullins, UK's Executive Associate Athletic Director. Mr. Wiseman said the University is requesting approval for three privately or federally funded projects. He said all of the projects have been approved by the University Athletics Board, the University Board of Trustees, and the Council on Postsecondary Education.

The first project discussed was the Football Practice Fields Renovation project. This project involves renovation of two grass practice fields and the conversion of a third field into a synthetic infield surface. The scope of the project is \$2,250,000.

Mr. Wiseman next discussed the Commonwealth Stadium Locker Room Renovation project. The University plans to renovate and consolidate two locker rooms, relocate showers and restrooms, and replace and repair air-conditioning and exhaust fans. The project scope is \$650,000. Mr. Wiseman said private funds from the University's intercollegiate athletics quasi-endowment fund (K-Fund) will be used for both projects.

Representative Damron asked what additional operating and maintenance costs will be associated with the Football Practice Fields Renovation project. Mr. Mullins said the maintenance costs associated with the fields should go down since they are eliminating one grass practice field. He said they are not adding a significant amount of square footage, so the cost should not increase. Mr. Wiseman said the athletics department pays for the cost of maintenance of those facilities, and no general funds are used.

In response to questions from Representative Damron, Mr. Mullins said the K-Fund is the old Blue White Fund. He said maintenance of the facilities is part of the University's operations.

Representative Damron asked if all the funds for this project are in hand or will K-Fund members be charged an increase in fees. Mr. Mullins said these projects should not require any direct increase.

In response to a question from Senator Buford, Mr. Wiseman said the University's physical plant division directly bills the athletics department for all the time and materials it spends on these areas. Mr. Mullins said the cost for operations and utilities will not be covered by the K-Fund, but will come from the operations budget.

The final project Mr. Wiseman reported was the Biomedical/Biological Sciences Research Building (BBSRB) Design Fit-Up of the Fourth Floor project. He said the University is requesting authority in the amount of \$850,000 to design the fit-up. The

design costs will be covered with federal funds and funds from the UK Research Foundation.

In response to a question by Senator Buford, Mr. Wiseman said the University has already been awarded \$3.6 million in federal funds, and the project will cost approximately \$8 million. However, he said all the university is asking for at this time is authorization to design the fit-up. Once they get firm design estimates, they will request authorization for the project from the General Assembly.

Representative Damron asked if these projects will be bid under prevailing wage statutes. Mr. Wiseman replied affirmatively.

Senator Moore made a motion to approve the three University of Kentucky projects. The motion was seconded by Senator Buford and passed by unanimous roll call vote.

Mr. Wiseman also reported that the University, on June 30, 2004, purchased the leasehold improvement known as the Lexel Building located on the University's Coldstream Research Campus for \$9,600,000.

Next, Mr. John Osborne, Associate Vice President for Campus Services and Facilities, Western Kentucky University (WKU) and Dr. Jennifer Tougas, Director of Parking and Transportation, WKU, reported an unbudgeted project to purchase new buses, acquire land, and construct a bus transportation center at a scope of \$3,069,561. The project allows WKU to use remote parking serviced by reliable buses to relieve a shortage of campus parking and to preserve green space on the central campus. Mr. Osborne said this project was approved the WKU Board of Regents and the Council on Postsecondary Education. Federal grant funds of \$2,455,649 will be matched by \$613,912 from two sources: \$306,956 from the Kentucky Transportation Cabinet and \$306,956 from WKU's restricted agency funds from parking and transportation revenues.

Representative Marcotte asked if the funds from the Transportation Cabinet are from the Road Fund. Mr. Bart Hardin, Committee staff, said it is his understanding those funds are from the state's General Fund, not the Road Fund.

Representative Damron made a motion to approve the WKU project. The motion was seconded by Senator Buford and passed by unanimous roll call vote.

Senator Leeper asked Mr. Bill Hintze, Deputy Budget Director, Governor's Office for Policy and Management, and Mr. James Abbott, Commissioner, Department for Facilities and Support Services, to present the Finance Cabinet's monthly report to the Committee. Mr. Hintze reported an Energy Savings Performance Contract (ESPC) initiated by the Department for Facilities and Support Services for the Cabinet for Human

Resources (CHR) campus. He said the project included all four buildings on the CHR Campus: the Health Services building, the main CHR Building, a central utility plant, and the Commonwealth Office of Technology Building. The energy improvements undertaken as part of this project include: lighting upgrade, water heat recovery chiller at the central utility plant, installation of HVAC variable air volume controls; water conservation measures, and window replacements. The total cost of the project, to be implemented by Siemens Building Technologies, is \$5,223,000. The financing structure being used is a long-term lease of the improvements to be paid through set payments over an 18-year period.

Senator Buford noted that the state will pay Siemens \$450,000 over the 18-term of the contract to monitor the savings and asked if there is not a better way for the Cabinet to handle these type of projects. He suggested that the state should review all state properties for energy improvements and then issue bonds to pay for the projects. He suggested that there would be significant savings to financing such projects through bonds.

Mr. Abbott agreed that there are other ways to approach these projects, and that the ESPCs are still relatively new to the Cabinet and they have faced a huge learning curve. He said that the Committee will see a change in how these projects are handled in the future.

Tom Howard, Acting Executive Director for the Office for Financial Management, said that as his office has evaluated the financing of these projects. They have concluded that there is a need to rethink the process and hope to have a recommendation for the Committee and the General Assembly in the 2005 Session.

Senator Buford asked if the Cabinet believes the improvements included in the CHR project have a useful life of 18 years (the financing term). Mr. Abbot said they are comfortable with the work being done as part of the project, but they are not comfortable with all the dynamics of the approach. Mr. Howard added that the savings are usually greater than what is guaranteed, but their cash flow analysis is very conservative and based only on the savings guaranteed.

Senator Buford expressed concerned about spending so much money (\$450,000) to monitor the savings.

Mr. Hintze said there are some significant policy issues related to ESPCs. He said the reason the legislation (Senate Bill 61) encouraging ESPCs was enacted in the 2002 Regular Session was a perceived need to upgrade the mechanical and electrical systems throughout state government. In the competition for scarce capital construction funds and bond indebtedness, this method of financing was viewed as an alternative that would not compete for bonded indebtedness and scarce capital construction funds because the

financing is carved out of operating budgets, based on energy savings to be generated. He said in response to Senator Buford's question as to whether it would be cheaper to do this through a more conventional way such as bonding, the answer is yes in many instances. However, he went on to say there is a question as to whether there is a collective will between the General Assembly and the Governor to make these improvements top priorities in the competition for capital funding. He noted that to date the state's track record in this regard has not been good--such projects have fallen by the wayside when other, "shinier" projects are proposed.

Representative Damron agreed with an estimate by Senator Buford that the state would save about 75 basis points by financing these project through bonds rather than as ESPCs. He said when the debt of the state is considered, we need to start considering lease payments, and whether it is rent or ESPC payments. If the state is leasing a building, that lease payment should be equivalent to a debt service payments. He said representatives from the bond rating agencies, Moody's, and Standard & Poor's, have told him they do include such leasing arrangements in their debt analyses. He said hopefully, they will look at this issue and save taxpayers money.

Representative Damron questioned the OFM cash flow analysis on the CHR project. He asked why the \$371,000 in cash that was paid up front as part of the project was excluded from the cash flow analysis. Mr. Howard responded that the \$371,000 is money in the agency's operating budget that they were going to spend for improvements regardless of whether the full project went forward. For that reason they did not include those funds in the cash flow analysis.

In response to a question from Representative Damron, Nancy Osborne, Committee Staff, said that 26% of the total cost of the project was for "soft costs" such as overhead, engineering, audits, and financing expenses. Mr. Abbott said that soft costs are incurred in normal capital construction projects, but the duration of the ESPC project currently before the Committee "compounds a lot of costs." He said the Cabinet had two projects pending--for the Department of Corrections and the Kentucky Transportation Cabinet. The Transportation Cabinet project is to replace all state traffic signals with LED lighting, and has a much more attractive payback of only four years.

In response to another question from Representative Damron, Mr. Howard said the Cabinet is competitively bidding the financing of ESPCs.

Senator Leeper then asked if the energy improvements are competitively bid. Mr. Abbott said they shortlist a group of firms, and then select three, based on their qualifications. One company is then selected to do an audit of the facilities to be included in the project. This audit can be time-consuming. For example, the ESPC project for the CHR campus involved 800,000 square feet. If after the audit is completed, the state does

not come to terms with the company concerning installation of the energy improvements, the state can then go to the company that was rated second to negotiate the work.

Senator Leeper noted that typically the company that does the analysis and establishes the scope of work to be accomplished is the same company that will do the construction work. He asked what safeguards are in place to assure the scope of work is not inflated. Mr. Abbott said his staff reviews the submittals and compares the proposed costs to industry information and to other state capital construction projects. He said his staff works very closely with the energy services provider, and often disagrees with the scope of work and how it is being approached. There is a lot of behind-the-scene-work and negotiation before a contract is finalized.

Mr. Hintze reiterated that Finance Secretary Rudolph is keenly attuned to this process and is trying to tighten it up. The 18-year term that was applied in the CHR campus project is the type of thing that is now under scrutiny.

Senator Leeper asked if it would possible for Mr. Hintze or Finance Secretary Rudolph to present a proposal for changes in ESPCs at the Committee's December or January meeting. Mr. Hintze indicated that they would brief the Committee as soon as they have additional recommendations. Senator Leeper said he would appreciate that and would ask the Committee's staff to get with Mr. Hintze and determine when a presentation would be made. No action was required on the ESPC report.

Mr. Hintze then reported an allocation of \$794,500 from the Emergency Repair, Maintenance and Replacement Account to address structural problems at Bradford Hall, located on the campus of Kentucky State University. Mr. Hintze said the project scope is \$908,500, and the University has limited resources available for this project - \$114,000 in interest income available from past bonds.

Allocations from the emergency account must be reported to the Committee within 30 days. Senator Leeper said no further action was required.

Mr. Hintze next reported an allocation of \$63,000 from the Capital Construction and Equipment Purchase Contingency Account for the Nolin Lake State Park Campground/Infrastructure Improvements project. The scope increase will be used to accept the low bid for construction of a modest office building and public restrooms. The revised scope would be \$178,258.

Mr. Hintze reported an unbudgeted project at the Wendell H. Ford Regional Training Center in Muhlenberg County. Mr. Hintze said this project is Phase VI in the development of the facility, and would provide additional barracks, a classroom complex, billet, fire station, and supporting facilities. The project scope is \$11,674,000, and is 100% federally funded.

In response to a question from Senator Leeper, Mr. Hintze said federal funds will be used to operate the facilities.

Senator Moore made a motion to approve the scope increase for the Campground/Improvements Project at Nolin Lake State Park and the unbudgeted project at the Wendell H. Ford Regional Training Center. The motion was seconded by Representative Damron and passed by unanimous roll call vote.

Mr. Steve Biven, Director for the Division of Real Properties, next presented a lease improvement for the Department of Military Affairs, in Franklin County (PR-4721) in the amount of \$29,551. He said this amount will be reimbursed by the federal government, and there is no cost to the Commonwealth. He said the improvements to be made include HVAC renovations and replacement of ceiling tiles.

Senator Buford asked if it is standard for the state to pay for improvements to an HVAC system and replace ceiling tiles in a building not owned by the state. Mr. Biven said since these items will be federally reimbursed, there will be no cost to the state. Mr. Joe Sanderson, Department of Military Affairs, said the modifications are being made to incorporate additional private offices in the leased space.

Mr. Biven presented another lease improvement in the amount of \$2,380 for the Governor's Office for Local Government, in Franklin County (PR-3657). The agency plans to remove a wall and seal a doorway.

Senator Leeper said included in members' folders was a report of state lease square foot modifications for July through September 2004. These modifications are under \$50,000; no further Committee action was required.

Senator Leeper then asked Mr. Warren Nash, Deputy Commissioner, Department for Financial Incentives, Economic Development Cabinet, to report on one Economic Development Bond (EDB) project. Mr. Nash reported a grant of \$125,000 to the Hart County Fiscal Court to benefit T. Marzetti Company. The company has announced the construction of a 220,000 square facility in the community of Horse Cave, Kentucky, at a cost of approximately \$38 million.

Mr. Nash said the EDB funds will be used to help offset a portion of the cost associated with site preparation for the project. In return for the grant, the company will be required to create 257 new full-time jobs within two years of grant disbursement and maintain these jobs for three years. If they do not create or maintain these jobs, the company will be required to pay the Hart County Fiscal Court \$486 per job not created or maintained. The newly created jobs are required to have average annual hourly wages as

follows: 18 new jobs @ \$12.92 per hour; 195 new jobs @ \$9.24 per hour; 33 new jobs @ \$16.91 per hour; and 11 new jobs @ \$11.51 per hour.

Senator Moore made a motion to approve the EDB project. The motion was seconded by Representative Marcotte and approved by unanimous roll call vote.

Ms. Sandy Williams, Kentucky Infrastructure Authority (KIA), next reported three new KIA loan requests and one loan amendment. The first was a \$1,052,104 Fund A loan for the City of Hodgenville in Larue County. The proceeds will be used for wastewater treatment plant improvements.

The second loan request was a Fund A loan assumption in the amount of \$198,914 for the City of Danville in Boyle County. The proceeds will be used to purchase the assets and assume liabilities of the utility system of the City of Perryville.

The third project Ms. Williams reported was a Fund B loan increase in the amount of \$300,000 for the Union County Fiscal Court as interim financing for construction of a nine-mile pressurized sewer main. The increase is due to delays in Union County receiving funds from a 2004 Congressional earmark in the federal budget. The increase brings the total amount of the loan to \$1,000,000.

Ms. Williams reported a Fund F loan for the McCreary County Water District in the amount of \$1,510,000. The proceeds will be used to expand the drinking water treatment plant.

Senator Buford made a motion to approve the four KIA projects. The motion was seconded by Representative Marcotte and passed by unanimous roll call vote.

Senator Leeper said also included in members' folders were reports from KIA regarding new Tobacco and Coal Development Grants and a 2020/Fund B grant. No further action was required on these projects.

The next report was provided by Mr. Tom Howard, Acting Executive Director, Office of Financial Management (OFM). Mr. Howard reported three new bond issues. The first bond issue was Kentucky Housing Corporation (KHC) Single Family Housing Revenue Bonds, 2004 Series GH or additional series as may be designated in an amount not to exceed \$50 million. The proceeds will be used to provide mortgage financing for first-time low and moderate income Kentucky homebuyers.

The second issue was KHC Conduit Multifamily Mortgage Revenue Bonds, Series 2004 A in Boone County (Florence Christian Homes – Phases I, II, and III). The proceeds from this bond issue (\$11,730,000) will provide conduit financing for the acquisition and renovation of a seniors housing facility in Florence, Kentucky.



The third issue was KHC Conduit Multifamily Mortgage Revenue Bonds, Series 2005 A in Jefferson County (Clarksdale Rental – Phase I). The proceeds (\$14,215,000) will be used to renovate a 60-year-old barracks style, antiquated public housing complex in Jefferson County.

Mr. Howard then introduced Ms. Lori Flanery, KHC General Counsel, to further discuss the issues. Ms. Flanery said the two multifamily conduit bond issues were approved by the KHC Board at its October 28 meeting as inducement resolutions. She said both projects were approved by the State Property and Buildings Commission on November 12, and there were public hearings on both issues. However, no comments were offered from the public.

Senator Buford made a motion to approve the three KHC bond issues. The motion was seconded by Representative Marcotte and passed by unanimous roll call vote.

Senator Leeper said included in members' folders were two follow-up reports for previously issued bonds: Kentucky Local Correctional Facilities Construction Authority Multi-County Correctional Facilities Revenue Refunding Bonds, Series 2004 (\$21,670,000); and Kentucky Economic Development Finance Authority Medical Center Revenue Improvement Bonds, Series 2004, Ashland Hospital Corporation d/b/a King's Daughters Medical Center project, (\$45,000,000). Senator Leeper said no action was required for these reports.

Mr. Howard next presented one new school bond issue (refunding) with School Facilities Construction Commission (SFCC) debt service participation for Casey County.

Senator Buford made a motion to approve the school bond issue. The motion was seconded by Senator Rhoads and passed by unanimous roll call vote.

Senator Leeper said there were five locally-funded school bond issues submitted to the Committee for review this month: Clay County, Estill County, Hopkins County, Russellville Independent (Logan Co.), and Simpson County. He said all disclosure information has been filed, and no further action on the bond issues is required.

Senator Leeper recognized Senator Moore, who will be leaving the General Assembly soon, and thanked him for his service. Senator Moore said this Committee was a pleasure to work with.

Also included in members' folders was the debt issuance calendar. Senator Leeper said no action was required for this report.

With there being no further business, Representative Damron made a motion to adjourn the meeting. The motion was seconded, and the meeting adjourned at 2:30 p.m.